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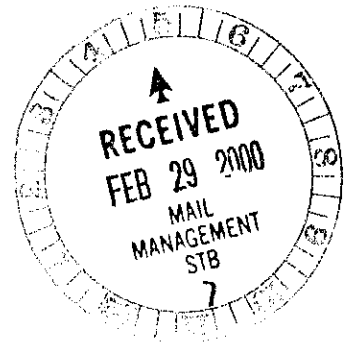
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February 29, 2000

BY HAND

Mr. Vernon A. Williams
Secretary
Surface Transportation Board
Office of the Secretary
Case Control Unit
1925 K Street, N.W.
Washington, D.C. 20423-0001

ENTERED
Office of the Secretary
FEB 29 2000
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Re: Ex Parte No. 582, Public Views on Major Rail Consolidations

Dear Mr. Williams:

Enclosed for filing in the above-referenced docket, please find an original and 10 copies of the Statement of Richard K. Davidson, Chairman and CEO of Union Pacific Corporation, and the accompanying Comments of Union Pacific. Also enclosed is a diskette containing the text of these documents in WordPerfect 7 format.

In accord with the procedures adopted by the Board in this proceeding (see Decision No. 3, served February 17, 2000, p. 2), Mr. Davidson's statement and the accompanying UP Comments should not be released to the public until the day of Mr. Davidson's scheduled testimony before the Board, i.e., Tuesday, March 7, 2000.

Please date-stamp the enclosed extra copies of these document and return it with our waiting messenger.

Thank you very much for your assistance.

Sincerely,

David L. Meyer

*Attorney for Union Pacific Corporation
and Union Pacific Railroad Company*

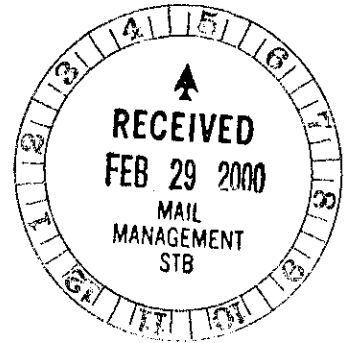
Enclosures

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STATEMENT OF RICHARD K. DAVIDSON

STB Ex Parte No. 582

Public Views on Major Rail Consolidations



Union Pacific appreciates this opportunity to provide its views on major rail consolidations. We built today's UP system through several mergers. We believe those mergers delivered substantial benefits to our customers and preserved the franchises of several financially weak railroads, including SP, M-K-T and WP. But the railroad industry is very different today than during most of the last two decades. Because of the possibility of more large mergers, the railroad industry today is financially vulnerable. We face the risk of crippling re-regulation and hostile takeovers by opportunists uninterested in the national rail system. Because of service problems related to mergers, our customers do not trust us and do not believe that we care about their interests. That is a sad state of affairs. We applaud the Board for recognizing the altered landscape of our industry and for taking a fresh look at the value of additional large railroad mergers.

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Office of the Secretary

FEB 29 2000

Why Is UP Here?

I will tell you why Union Pacific is here today. But first I want to dispel some of the inaccurate rumors and theories you may be reading in the press or hearing from other parties.

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- ☆ Size. We don't believe that UP has a manifest destiny to be the biggest railroad or that we must be as big as any other railroad in order to compete. UP wants to be the best railroad for its customers, its employees and its investors, not necessarily the biggest.
- ☆ Competition. We don't fear competition from a combined CN/BNSF. We are confident that we can compete against CN/BNSF, working in cooperation with CP and other carriers. If an application is filed, we would expect the Board to resolve the merger's anti-competitive effects, which would help us compete more effectively.
- ☆ More UP mergers. We are not trying to get our house in order so we can do a big merger of our own. If we wanted to do another merger, UP's house is already in order. As the STB has found, our service has recovered from the problems that followed the UP/SP merger. For several commodities, one survey ranks UP ahead of BNSF, CN and every other Class I railroad in both on-time delivery and customer service. But we don't think our service is as good as it should be, and we think that's where we should focus our attention. We, along with every other railroad, need to improve service to meet more of our customers' needs.

Anyone who knows me knows that I'd like to be involved in the first transcontinental merger. I'd like to prove that we can do a good job with a transcontinental merger. But we took a hard look at a merger a few months ago, and we decided we should not propose one. We decided that in today's railroad environment, any merger of Class I railroads would be irresponsible and dangerous. That is why we are here today.

The Threat of Re-Regulation

UP is here first and foremost because we want to avoid disastrous re-regulation of our industry. Regulation drove the railroad industry to the brink of failure in the 1970s. Proposals to merge Class I railroads will encourage re-regulation, reversing two decades of progress. We think it is unwise for any pair of Class I railroads to propose a consolidation when the risk of re-regulation is so great.

- ☆ Increasing Risk. Merely announcing a big railroad merger increased the demands for re-regulation. Immediately after the CN/BNSF merger announcement, some groups called for re-regulation. You are going to hear from individual shippers and organizations that want re-regulation in connection with future mergers.
- ☆ Effects of Re-Regulation. Re-regulation would cripple UP's ability to invest in infrastructure and to provide the services we offer today. Based on a careful study of the effects of re-regulation on UP, we believe it would eliminate the majority of our earnings. Re-regulation would cost us more than \$750 million annually in operating income.

If UP loses this income, we will be forced to disinvest in the railroad and cut back services. If the federal government told American Airlines to charge every passenger the lowest excursion fares, American would not be able to own as many airplanes, fly as many flights, or serve as many cities as it does today. The same would happen to UP if the industry is re-regulated. We are not earning our cost of capital today, yet we would face a much deeper shortfall. We anticipate that we would be forced to discontinue much of our carload business and large parts of our intermodal business. We certainly would not build the new intermodal terminals now planned, such as the planned \$190 million Global III terminal outside Chicago. We would scrap plans to expand capacity on most routes. We would be forced to defer maintenance. We would abandon substantial parts of the railroad that are now profitable but would no longer be viable.

- ☆ BNSF's Position. Three years ago, Rob Krebs told you: "I see grave risks for railroads, shippers and our national transportation system in the re-regulatory measures that the Board is considering." He also said, "The first casualty would be capital investment." He was right.

Rob said something else I agree with. He referred to “the dismal prospect of trying to run a business and raise capital under a cloud of regulatory uncertainty.” That’s precisely what the railroad industry is trying to do today. The CN/BNSF merger announcement created a cloud of uncertainty that is severely sapping the railroads’ financial strength.

- ☆ Instability in the Equity Market. The equity markets are sending a clear message that something is wrong with proposals for big rail mergers right now. As the attached chart shows, the CN/BNSF merger announcement caused stock values of large railroads, including BNSF and CN, to fall by about 25 percent, costing investors billions of dollars. The total equity value of the Class I railroads fell by roughly half to only about \$30 billion. Interest in rail stocks has virtually disappeared. Railroads could not obtain equity financing today if they wanted to.
- ☆ Risk of Takeovers. With stock prices so low, every major railroad is a potential takeover target. That situation is distracting railroad managers today, and portends a dangerous future. A corporate raider with no interest in running a railroad could descend on one of the major railroads and take it private using a leveraged buyout. The buyer would strip whatever assets it could from the railroad, defer maintenance to increase cash flow, cannibalize the railroad, make deals that burden the property, and then pull out the cash while allowing the company to decline. The Board could not stop a takeover. Remember that the Japonica group tried in the 1980s to take over CNW and strip it. We haven’t faced a serious takeover risk for years, but we do today because the prospect of another wave of railroad mergers and the associated risk of re-regulation are devastating share values.

Rob Krebs and Paul Tellier have the power today, right now, to remove the cloud of uncertainty hanging over this industry and to rejuvenate the railroads’ financial strength. They could cancel their ill-timed merger plans for the good of their stockholders and the national rail transportation system.

Loss of Focus on Service Quality

One of our reasons for being here is our concern about re-regulation, but an equally important concern is the railroad industry’s loss of focus on Job No. 1. Job No. 1 is improving service to our customers.

- ☆ Improving Service. With mergers behind us, BNSF, CN and UP are making strides toward better service. The eastern railroads are working hard on solving service problems. But when most of our shippers hear talk of more mergers, they say, “You guys just don’t get it, do you?” They want us to focus on service.

That's where this industry should put its attention.

- ☆ Diversion of Resources. Because of the CN/BNSF proposal, the railroad industry is diverting management time and money from service to mergers. All of the big railroads are pouring money into lawyers, experts and lobbyists. CN and BNSF appear to be devoting unprecedented resources to promoting their consolidation. Senior managers are spending valuable time worrying about mergers instead of meeting the needs of shippers.

Another wave of big mergers would occupy the industry's attention for years. The regulatory process takes more than a year, then it takes several more years to implement a merger. We have more important work to do right now. We need to improve service and plan for future growth.

Are Mergers Worth the Risks?

At UP, we think the railroad industry should not risk re-regulation and loss of customer focus unless the need for mergers between Class I railroads is overwhelming. It is not. No Class I railroad in the U.S. or Canada needs to be rescued by merger in order to survive or compete. With fewer big railroads, the railroad industry today has many new opportunities to improve interline and on-line service. New technology is about to revolutionize the industry. We should explore these alternatives to mergers before we permanently change the railroad map again.

- ☆ Cooperation. Railroads can more easily cooperate to provide quality interline service than in the past. With only two big railroads in the East, two in the West and two in Canada, coordination is easier than when a dozen railroads had to reach consensus. Railroads have been exploring many new possibilities for cooperation. For example,
 - Interline Service Management and Interline Service Agreements. The industry is making significant progress toward improving interline service. We are well on our way to solving the basic problem of data consistency between railroads. Each pair of railroads is developing for the first time an agreement to ensure quality interline service between their two systems.
 - Joint dispatching. BNSF and UP have pioneered a new and better way to move trains through congested terminal areas. We set up joint dispatching centers to control train operations on both railroads in Houston and Southern California. These centers work beautifully. BNSF reported that its Southern California trains perform ten percent better now. That is due to joint dispatching, not due to the BNSF merger. We can set up

more dispatching centers in other terminal areas and make more progress.

- Terminal improvements. Railroads are pursuing unprecedented joint efforts to improve operations in terminal areas. Our most ambitious project is to coordinate operations and reduce congestion in Chicago.
- ☆ E-business. Electronic commerce may completely change the railroad industry in only a year or two, and it might make mergers less useful. Soon we may see e-commerce alter commercial relationships, improve interline service and achieve new efficiencies.
- BNSF's "revolution". BNSF announced a new subsidiary called FreightWise, Inc., which will be an "electronic marketplace for buyers and sellers of transportation." BNSF says that FreightWise is "revolutionizing the industry." Shouldn't we find out how far that revolution will take us before automatically resorting to mergers?
- New marketing options. Within months, electronic vendors plan to create new online markets. The AAR is developing an industrywide e-commerce website. The "steelroads.com" demonstration is now available on the Internet. By the end of this year, shippers should be able to use these systems to arrange transportation on any railroad or motor carrier; to reserve cars or trailers; and to agree on financing, insurance, service guarantees and every other aspect of transportation. One of BNSF's biggest customers, Schneider National, said that e-commerce "will change the way we do business."

Marriages of Class I railroads are unlikely to provide overwhelming benefits. Mergers that are mostly end-to-end have provided fewer public benefits than parallel mergers, and that is especially true in the wake of cost-reduction programs on all major railroads. For example, the CN/IC merger was supposed to take \$165 million in traffic from UP, but we don't see any sign that it is having any effect on us at all. The CN/BNSF merger appears to offer only modest benefits.

Big Mergers: When?

At UP, we know that this is the wrong time for another big merger. Will there be a right time? We don't know yet. It is too early to make that call

We should not have another Class I combination while there is a real risk of devastating re-regulation.

We should not have another Class I combination before we explore opportunities for cooperation and use of new technology.

We should not have another Class I combination until the customer community sees benefits in additional large railroad mergers.

“Downstream” Effects of a CN/BNSF Merger

So far I have been talking about the current state of the railroad industry. But the Board asked for views on what will happen if another big merger is approved.

- ☆ More Mergers. If the CN/BNSF merger is approved, UP and every other railroad would be forced to reconsider mergers. By approving that merger, the Board would send a strong message that it is likely to approve additional mergers. Additional mergers would be inevitable.
 - BNSF. Rob Krebs has already announced that he wants to go after an eastern railroad next. Earlier this year he told the *New York Times*, “Market forces are demanding a transcontinental system.” He told stock analysts, “It’s going to happen; we are ready.” Then he said, “There is still one eastern carrier over there that is pretty much driven into the arms of the BNSF/CN.”
 - Other Railroads. Rob won’t be the only one pursuing additional mergers. Other railroads will feel compelled to pursue them, even if they think more mergers would be dangerous for the industry. Each of the remaining large railroads will know that it is competing for one of only two partners for a transcontinental merger. Each of us will think that one of the partners is better than the other. Each of us will know that if we get that option, we will have an advantage that will last forever because mergers are permanent. Each of us will worry about what the other railroads might do. The temptation will be too strong to resist, even if more mergers are a bad idea for the industry and for our customers.
- ☆ Even Greater Risks of Re-Regulation. If a Class I merger is approved, the risk of re-regulation will increase. Those who want more regulation will tell Congress that the STB was unable to protect them. Some will argue that mergers reduce competition. But if the railroads are re-regulated, all of us will regret it. We should remember the 1970s when regulation was driving the railroads out of business.

Conclusion

- ☆ This is not the time for Class I railroads to merge. If we continue to push for big mergers, those who seek re-regulation will push harder and are more likely to succeed, with devastating consequences. If we continue to push for big mergers, our customers will continue to doubt our commitment to their interests.
- ☆ All of us in the rail industry should put aside our urge to seek strategic advantages through mergers. We should focus our efforts on restoring the financial health of our industry. The best way to do that is to focus on the needs of our customers for more dependable rail service.

February 29, 2000

Stock Price Performance

December 1, 1999 to Present

